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Fred K. Stocks and Brenda K. Stocks v. United States Fidelity and Guaranty Company, a Corporation and the Talbert Corporation, a Corporation : Reply Brief

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

FRED K. STOCKS and BRENDA K.
STOCKS,

Plaintiffs - Appellants,

vs.

UNITED STATES FIDELITY AND
GUARANTY COMPANY, a Corporation
and THE TALBERT CORPORATION, a
Corporation,

Defendants - Appellees.

Case No. 990624-CA

Oral Argument Priority 15

REPLY BRIEF OF APPELLANTS

APPEAL FROM A FINAL JUDGMENT
OF THE SEVENTH DISTRICT COURT OF SAN JUAN COUNTY,
THE HONORABLE BRYCE K. BRYNER

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COURT OF APPEALS

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Oral Argument Priority 15

REPLY BRIEF OF APPELLANTS

RESPONSE TO STATEMENT OF FACTS

On pages 3-4 of its brief, The Talbert Corporation asserts that Fred and Brenda Stocks have not personally paid the legal expenses of Timber Products but have only guaranteed corporate debt. Talbert gives no citation for this assertion. The record is to the contrary. Paragraph 19 of plaintiffs' Verified Complaint states that "plaintiffs have been required, at a great personal and financial sacrifice and risk to themselves, to undertake to provide Timber Products with the substantial financial means that have been and are required to enable Timber Products to defend itself against the Claims." In paragraph 23.a. of the Verified Complaint, Stocks further asserted that "plaintiffs

have foreseeably been required to make, at great personal financial sacrifice, hardship and risk to themselves, to undertake to provide the financial means to Timber Products to enable it to defend itself against the Claims" Because this case was decided on summary judgment, this Court is required to draw all reasonable inferences from the statements in the Verified Complaint and to resolve all doubts in favor of allowing the case to proceed to trial. Bowen v. Riverton City, 656 P.2d 434, 436 (Utah 1982).

The quoted provisions of the Verified Complaint support the inference that plaintiffs did not merely guarantee loans to the corporation, but personally provided the money necessary to defend the corporation.¹ Plaintiffs' claims in this case are based in part on their status as personal financiers for the corporation because plaintiffs were required to fund the defense that defendants failed to provide. That plaintiffs personally funded the defense of the corporation is a reasonable inference from paragraphs 19 and 23.a. of the Verified Complaint, and this Court is therefore required to presume that plaintiffs did personally fund the defense.

¹ Plaintiffs have in fact loaned thousands of dollars to the corporation, and the loans are reflected on corporate books.

ARGUMENT

POINT I

STOCKS' CLAIMS ARE NOT MOOT.

USF&G argues Stocks' claims in this action are moot because the trial court has entered a ruling in a related action holding there was no coverage for the damages caused by fire. This argument should be rejected for several reasons.

While the trial court in a related action has ruled there was no coverage, Timber Products still has valid claims pending in that action against both Talbert and USF&G for failure to provide appropriate insurance. In a ruling made February 25, 1999, the court in that action held that there was a material issue of fact as to whether Talbert was an agent of USF&G. As was explained more fully in Point II of plaintiffs' initial brief, Talbert and USF&G owed a duty to Stocks personally to arrange for adequate insurance coverage for Stocks and their companies. That claim by Timber Products is still valid in the Timber Products case, and nothing in the trial court's rulings in that case would preclude Stocks from asserting that claim in this case.

A second reason why the claims here are not moot is that the rulings in the Timber Products case are not yet final, and when final will be subject to appeal. The rulings in the Timber Products case would preclude litigation of similar issues in this

case only if those rulings were final. Madsen v. Borthick, 769 P.2d 245, 247 (Utah 1988). In addition, several Utah cases hold that a ruling should not be given preclusive effect if an appeal is pending. DeBry v. Noble, 889 P.2d 428, 444 n.17 (Utah 1995). USF&G's suggestion that this case is moot should be rejected.

POINT II

PLAINTIFFS HAVE STANDING TO PURSUE THEIR PERSONAL CLAIMS.

Both USF&G and Talbert argue that a shareholder may not pursue claims for wrongs done to the corporation. (Talbert brief at 5, USF&G brief at 8.) Plaintiffs do not disagree and acknowledged in their brief that "some of the harm suffered by Stocks comes as a result of their stock ownership" and that such claims properly belong to the corporation. (Stocks brief at 14.) USF&G has focused its arguments on proving the conceded point that a shareholder as such cannot sue in its individual capacity for wrongs done to the corporation; there is no persuasive authority in its brief to show that Stocks do not have standing to sue for the wrongs to them personally, which are separate and distinct from their injuries as shareholders.

Both parties have cited to the Utah Court of Appeals decision in DLB Collection Trust v. Harris, 893 P.2d 593 (Utah Ct. App. 1995). The court in that case relied on the rationale of the Colorado Court of Appeals in Nicholson v. Ash, 800 P.2d 1352 (Colo. Ct. App. 1990). As in DLB, the plaintiff in Nicholson was a

bank shareholder who claimed that the mismanagement of other shareholders had led to the demise of the bank. The primary issue in Nicholson was whether the other shareholders owed Nicholson a fiduciary duty. While the court acknowledged that the shareholders might owe him a fiduciary duty as shareholders, they did not owe him a fiduciary duty as a guarantor:

As the trial court recognized, plaintiff's agreement to guarantee certain debts did not enhance his status as a *stockholder*. Rather, that action resulted in plaintiff having *two* relationships with the corporation—one created by his purchase of stock and one resulting from his guarantee of the debt.

As a stockholder, the directors owed to plaintiff various fiduciary obligations. These same obligations, however, are not owed to guarantors or other corporate creditors.

Further, the damage suffered by plaintiff, which he claims is unique, was suffered as a result of his loan guaranty and the corporations' failure to fulfill their implied obligation to indemnify him from any loss thereunder. By reason of such failure of indemnification, plaintiff sustained a *creditor's* loss; this loss was unassociated with plaintiff's status as a stockholder.

Nicholson, 800 P.2d at 1357 (citation omitted).

In other words, Nicholson actually supports the concept that an individual may wear various hats with respect to a corporation, and the court must analyze each relationship separately. The fact that Stocks happen to be shareholders does not mean they automatically lack standing to sue for individual wrongs suffered in their capacity

as financiers. Nicholson recognized that "if the stockholder is a party to a contract, whether express or implied, with the directors or some other third party, he may maintain a personal suit against that third party. However, in such cases the *status* of stockholder is of *no importance*, since he sued in his individual capacity." Nicholson, 800 P.2d at 1356 (citations and quotation marks omitted, italics in original).

The statements in Nicholson are consistent with the recent opinion of the Utah Supreme Court in Aurora Credit Services, Inc. v. Liberty West Development, Inc., 970 P.2d 1273 (Utah 1998). The Court there gave examples of derivative suits by shareholders and then compared direct actions by shareholders:

If the injury is one to the plaintiff as a stockholder and to him individually, and not to the corporation, as where the action is based on contract to which he is a party, or on a right belonging severally to him, or on a fraud affecting him directly, it is an individual action.

Put differently, in a direct action, the plaintiff can prevail without showing an injury to the corporation--the shareholder need show only an injury to him- or herself that is distinct from that suffered by the corporation.

970 P.2d at 1280 (quotation marks, brackets, and citations omitted).

Fred and Brenda Stocks are shareholders in Timber Products, but their claims do not arise out of that status. Stocks personally met with Talbert (USF&G's agent) and asked Talbert to provide appropriate insurance for Stocks and their companies. Stocks are a named insured on the insurance ultimately provided. Stocks therefore have a claim against Talbert and USF&G for breach of Talbert's duty to provide

appropriate insurance for Stocks' companies. Stocks also personally funded the legal defense. Finally, Stocks personally suffered the loss of peace of mind and other emotional, but very real, injuries resulting from the defendants' failure to provide adequate insurance.

None of the cases cited by Talbert or USF&G address this type of situation, nor are they persuasive on whether Talbert or USF&G is liable to Stocks for breach of duty. Jordan v. United States Fidelity and Guarantee Company, 843 F. Supp. 164 (S.D. Miss. 1993), cited on pages 11-12 of USF&G's brief, involved only the issue of whether a stockholder as such can sue for emotional injuries resulting from the insurer's failure to defend. The case is inapplicable because Stocks are not suing as shareholders.

The dictum in Herzing v. Metropolitan Life Insurance Co., 907 S.W.2d 574, 585 (Tex. Ct. App. 1995), cited by USF&G at page 13 of its brief, is not persuasive in this case. The plaintiffs there claimed personal involvement because they had paid a brokerage fee to obtain a loan for their corporation. It does not appear from the opinion that the individuals were seeking recovery of the brokerage fee, but only for their emotional injuries because the corporations did not receive the loans. That is very different from this case, where Stocks are seeking to recover the thousands of dollars they have been required to pay to mount a defense for the corporation.

The emotional injury issue is also distinguishable because the very purpose of purchasing insurance is to provide peace of mind. Beck v. Farmers Insurance Exchange, 701 P.2d 795, 802 (Utah 1985). Stocks employed Talbert to provide appropriate insurance for Stocks' corporations, one of the purposes of which was to provide peace of mind to Stocks. Because the purpose of the insurance was to provide peace of mind, this is distinguishable from Herzing, where there was no claim that the loans were sought to obtain peace of mind.

Similarly, in Maryland Staffing Services, Inc. v. Manpower, Inc., 936 F. Supp. 1494 (E.D. Wis. 1996), the plaintiffs alleged claims arising away from their status as shareholders. There were no allegations that the individual plaintiffs had a status other than shareholders.

The statement in Hammes v. Aamco Transmissions, Inc., 33 F.3d 774, 777 (7th Cir. 1994), is also dictum, but the individuals in that case were permitted to sue for wrongs to the corporation, the court holding the defendants had waived the defense. 33 F.3d at 778.

In the instant case, contrary to all the cases cited by defendants, Fred and Brenda Stocks suffered damages arising from the fact that they personally contracted with the insurance agent to provide insurance other companies, and from the fact that they were required to personally finance the defense for the corporation when the insurance company failed to do so. These are not injuries arising from their status as

stockholders, but rather from their independent contract with the insurance company. They have standing to pursue those personal claims.

Talbert also asserts the puzzling claim that "a plaintiff cannot recover for negligent infliction of emotional distress arising from breach of contract." (Talbert's brief at 8.) Talbert then launches into a discussion of the rules under which a bystander witness to a tort can recover for the bystander's emotional injuries. The discussion is completely inapposite. Talbert's claims are not based on having witnessed a breach of contract, but rather arise from breach of Talbert's duty, owed directly to Stocks, to provide adequate insurance for Stocks and their companies. As explained in Beck v. Farmers Insurance Exchange, 701 P.2d 795, 802 (Utah 1985), "[a]n insured frequently faces catastrophic consequences if funds are not available with a reasonable period of time to cover an insured loss." Beck further held that "we find no difficulty with the proposition that, in unusual cases, damages for mental anguish might be provable." Id. Plaintiffs' have suffered such damages in this case and are entitled to recover for the emotional injury caused by defendant's failure to provide adequate insurance.

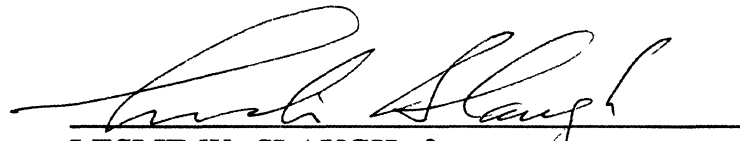
CONCLUSION

Stocks' damages are personal to them, and arise from their undertaking to defendant the corporation when defendants' failed to do so, and from the defendants'

breach of their duty, owed to Stocks personally, to obtain adequate insurance for Stocks' companies. Stocks have standing to pursue these personal claims.

This Court should reverse the trial court's dismissal of plaintiffs' complaint, and remand this case for trial on the merits.

DATED this 22nd day of March, 2000.


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MAILING CERTIFICATE

I hereby certify that two true and correct copies of the foregoing were mailed to each of the following, postage prepaid, this 22nd day of March, 2000.

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